

VZCZCXYZ0004  
PP RUEHWEB

DE RUEHDM #0127/01 0391450  
ZNY CCCCC ZZH  
P 081450Z FEB 07  
FM AMEMBASSY DAMASCUS  
TO RUEHC/SECSTATE WASHDC PRIORITY 2932  
INFO RHEHAAA/WHITE HOUSE WASHDC PRIORITY  
RUCQSAB/USSOCOM INTEL MACDILL AFB FL PRIORITY  
RHEHNSC/NSC WASHDC PRIORITY  
RUEATRS/DEPT OF TREASURY WASHDC PRIORITY  
RUEAIIA/CIA WASHDC PRIORITY

C O N F I D E N T I A L DAMASCUS 000127

SIPDIS

SIPDIS

NEA/ELA; NSC FOR MARCHESE

E.O. 12958: DECL: 01/28/2017  
TAGS: [ECON](#) [EFIN](#) [EINV](#) [PREL](#) [SY](#)  
SUBJECT: SYRIA'S MOST IMPORTANT ECONOMIC REFORM: THE  
BANKING SECTOR

REF: A. 06 DAMASCUS 05371

[1](#)B. 06 DAMASCUS 02632

[1](#)C. 06 DAMASCUS 00197

Classified By: Charge d'Affaires Michael Corbin, reasons 1.4 b/d

[1](#)1. (C) SUMMARY. The SARG continues to spotlight its efforts to modernize the financial sector and achieve economic equality with its Arab neighbors, but the banking sector as the SARG-proclaimed "model" of sectoral reform falls well short of the propaganda. The SARG continues to lack the political will to overhaul the corrupt public banking sector, which accounts for 90 percent of the market, or implement meaningful structural reform. As a result, the nascent private banks continue to adopt conservative business plans that do not significantly spur economic growth. And although the SARG has recently announced it will speed up financial reforms, experts remain skeptical of the SARG's political will or ability to implement significant change in [1](#)2007. End Summary.

[1](#)2. (SBU) PUBLIC BANKS DOMINATE BANKING SECTOR: Following the Ba'ath Party's takeover of power and the nationalization of the financial sector in 1963, state-owned banks became a mechanism through which the SARG financed public enterprise and regime-sanctioned corruption. Over the next forty years, there was virtually no private sector access to credit or commercial banking services for average Syrians. After President Bashar Asad's ascent to power, the SARG began to highlight its efforts to reform the financial sector and move towards a market-based economy. The most important reform was the legalization of private banks in April 2001. The first three private banks opened their doors in January 2004 and there are now nine private banks, including two Islamic banks, licensed for operation in Syria (ref A). Despite the growth of the private banking sector and the SARG rhetoric, the government continues to control the financial sector and use public sector banks, which dominate the market, to finance unprofitable public spending and offset losses from corruption.

[1](#)3. (C) PUBLIC BANKS REMAIN INEFFICIENT AND CORRUPT: The Commercial Bank of Syria (CBS), one of five public sector banks in Syria, monopolizes the banking sector with 90 percent of all deposits and control over most of the country's foreign currency reserves. The four other specialized public banks are the Agricultural Cooperative Bank, the Industrial Bank, the Real Estate Bank, and the People's Credit Bank. The public banks continue to tie public sector lending to political connections and corruption

rather than a sound business plan. As a result, sources report that as much as 50 percent of public bank loans to public enterprises are non-performing. Public sector banks are also continuing to expand their portfolios, with the IMF estimating that public sector lending increased by approximately 42 percent in 2005 (ref B). Although the SARG has discussed possible EU support for reforming the sector, it has yet to conduct even a comprehensive audit of the banks to assess needed changes or the extent of its potential exposure.

14. (C) OBSTACLES TO REFORM: Beyond the public sector banks, the SARG is not addressing other obstacles to modernization of the financial sector, including the lack of human capacity, transparent regulations, and regulatory management of the sector. There are four competing figures for primacy in the sector: the Deputy Prime Minister for Economic Affairs, Abdullah Dardari; the Governor of the Central Bank, Adib Mayaleh; the Director-General of the Commercial Bank of Syria, Dureid Dergham; and the Minister of Finance, Mohammad Hussein, most of whom have testy personal relations with each other and very different approaches to managing and reforming the financial sector. A specific example of their internecine in-fighting is the ill-fated Syrian banking association. Originally envisioned by private banks as a way to share solutions and develop a much-needed training center, it is now at the center of a political tug-of-war between the self-promoting, French-educated Governor of the Central Bank and the Baathist, Romanian-educated Minister of Finance. As a result of their zero-sum approach to reform the association has not taken form and the sector continues to lack any platform for professional development.

15. (C) RISK ADVERSE PRIVATE SECTOR BANKS: Unlike for the public banks, some of the SARG's reforms - such as the recent easing of restrictions on bank accounts and foreign trade

(banks can now cover up to 100 percent of the foreign exchange necessary for imports) - have enabled the private banking sector to slowly expand (ref C). An additional commercial bank, the Bank of Syria and the Gulf, (the first private Gulf bank in Syria) was licensed in 2006, as were the first two Islamic banks - the Syrian International Islamic Bank and the Cham Bank. The existing private banks are also expanding branches and services, attracting consumer deposits, and realizing profits. Nevertheless, private banks are pursuing very conservative business plans because of the continuing political risk and structural hurdles inherent in Syria's banking system, including: 1) interest rates that encourage short-term deposits while demand for loans are mid to long-term; 2) a lack of reliable financial statements or a credit bureau to assess potential borrowers; 3) an inefficient and corrupt judicial system; and 4) a lack of capital investment instruments. As a result, private banks are not extending significant credit or injecting capital into the economy ) limiting long-term growth in critical economic sectors, such as agriculture, industry, and tourism.

16. (C) FUTURE PROSPECTS FOR FINANCIAL SECTOR REFORM: The SARG has announced a new set of financial reforms to be implemented in 2007 as part of its efforts to use the banking sector to transform other economic sectors. Yet bankers remain skeptical of these reforms, which include instituting a single exchange rate for the Syrian pound; raising the foreign ownership ceiling for private banks from 49 percent to 60 percent; increasing the required private bank capitalization from 30 million to 100 million (and for the Islamic banks, from 100 million to 200 million); and introducing a Syrian pound treasury bill as a first capital investment instrument. Bankers assert that even if reforms are implemented quickly and effectively, the moves still do not address the issues of burdensome and inconsistent regulation, a lack of competent oversight of the sector, and the needed privatization or reform of the public sector banks. Consequently, our private sector banking contacts judge the proposed SARG "reforms" as unlikely to encourage a significant increase in foreign investment in the short-term

) especially given the continuing political uncertainties and an overall unfavorable investment environment in Syria.

17. (C) COMMENT: Throughout 2006, the SARG asserted that its recent banking reforms are a catalyst for economic growth. Yet, while the private sector banks are moving ahead, the ability of the banking sector to spur growth continues to be hampered by the slow SARG reform process and the outdated public banking sector. The lack of political will to implement meaningful reform can in part be ascribed to regime officials who are unwilling to give up control of a financial sector that gives them cover for their corrupt business deals. A second impediment to more meaningful reform is the nature of the regime's leadership philosophy - play subordinate leaders off one another to keep any one from getting too strong and developing his own power base. Ultimately, the lack of reform and increase in number of non-performing loans in the public sector banks are creating a vulnerability that the SARG continues to ignore at its own peril.  
CORBIN